

Supreme Court: Hears Oral Arguments on (1) Whether State Courts Have Jurisdiction Over Class Actions Alleging Only '33 Act Claims; and (2) Who Qualifies as a “Whistleblower” Under the Dodd-Frank Act’s Anti-Retaliation Provisions

12.18.17



(Article from *Securities Law Alert*, November/December 2017)

For more information, please visit the [Securities Law Alert Resource Center](#)

On November 28, 2017, the Supreme Court heard oral arguments in two significant securities law cases: *Cyan v. Beaver County Employees Retirement Fund*, No. 15-1439, in which the Court will decide whether a class action alleging only violations of the Securities Act of 1933 (“the ‘33 Act”) may be brought in state court; and *Digital Realty Trust v. Somers*, No. 16-1276, in which the Court will determine whether the Dodd-Frank Wall Street Reform and Consumer Protection Act’s (“Dodd-Frank Act”) anti-retaliation protections apply to an employee who makes internal disclosures of allegedly wrongful activity, but does not report the activity to the SEC.

Justices Question Whether SLUSA Divested State Courts of Jurisdiction Over Class Actions Alleging Only '33 Act Claims

After the Private Securities Litigation Reform Act of 1995 (“PSLRA”) imposed heightened pleading requirements for federal securities fraud class actions, plaintiffs began filing securities fraud class actions in state courts asserting violations of state law. Congress responded by enacting the Securities Litigation Uniform Standards Act of 1998 (“SLUSA”), which provides that “[n]o covered class action based upon the statutory or common law of any state ... may be maintained in any State or Federal court by any private party alleging” securities fraud. 15 U.S.C. § 77p(b). SLUSA further provides that “[a]ny covered class action brought in any State court involving a covered security, as set forth in subsection (b), shall be removable to Federal district court.” 15 U.S.C. § 77p(c).

Prior to SLUSA’s enactment, federal and state courts had concurrent jurisdiction over actions asserting ‘33 Act claims pursuant to 15 U.S.C. § 77v(a). SLUSA amended Section 77v(a) to add the italicized language: “The district courts of the United States ... shall have jurisdiction ... concurrent with State and Territorial courts, *except as provided in [S]ection 77p of this title with respect to covered class actions.*” SLUSA also amended § 77v(a)’s removal bar as follows: “*Except as provided in [S]ection 77p(c) of this title*, no case arising under” the Securities Act of 1933 “shall be removed to any court of the United States.”

At issue in *Cyan* is whether Congress intended to divest state courts of jurisdiction over all class actions brought under the ‘33 Act. Lower

courts are deeply divided on the issue. Some fifty-five federal court decisions have taken divergent positions on whether state courts have subject matter jurisdiction over '33 Act claims in the aftermath of SLUSA. In general, federal district courts in California have held that state courts retain jurisdiction over '33 Act claims, while many courts outside of California have held that SLUSA eliminated state court jurisdiction over such actions.

The oral argument focused heavily on the proper reading of § 77v(a). Cyan argued that the text, structure, and purpose of SLUSA reveal Congress's intent to divest state courts of jurisdiction over class action cases alleging '33 Act claims. Under this reading, SLUSA should be read to provide exclusive jurisdiction to federal courts over '33 Act class actions, bringing it into line with the treatment of claims asserted under the Securities and Exchange Act of 1934 ("the '34 Act"). To Cyan, the natural reading of the statute demonstrates that Congress intended to amend the '33 Act in order to curtail the efforts to evade the dictates of the PSLRA. Cyan also argued that SLUSA's legislative history reflected Congress's intent to make federal court the "exclusive" and "only" venue for hearing federal securities class actions.

The United States, participating as *amicus curiae*, argued for a more limited reading than Cyan, but one that would nonetheless allow state court suits asserting exclusively '33 Act claims to be removed to federal court. According to the Solicitor General, nothing in SLUSA prevents state courts from maintaining concurrent jurisdiction over covered class actions that only allege '33 Act claims. The Solicitor General argued, however, that § 77p(c) permits the removal of "[a]ny covered class action brought in any State court involving a covered security, as set forth in subsection(b)." Therefore, the government took the position that though state courts retain concurrent jurisdiction to hear covered class actions that allege only violations of the '33 Act, such cases may nevertheless be removed to federal court if the defendant so chooses.

Respondent investors argued that SLUSA was intended to prohibit the filing of certain securities class actions under state securities laws, not to prohibit the litigation of '33 Act claims in state court. Respondent further argued that the provisions of SLUSA limiting state court jurisdiction and allowing removal apply only to cases asserting both state law claims and '33 Act claims, not to those asserting exclusively '33 Act claims. In other words, Respondent argued that SLUSA was written to root out the most abusive practices of securities class actions, not to prevent state courts from hearing these cases at all. Respondent pointed out that Congress could have clearly and easily eliminated concurrent jurisdiction for '33 Act claims had it wished to do so. Because the language of SLUSA does not contain such clear language and instead is far more limited, Respondent argued, SLUSA clearly provided that state courts should retain concurrent jurisdiction for class actions brought exclusively under the '33 Act.

The one conclusion that the Justices appeared to reach was that the relevant language in SLUSA was far from clear. Indeed, Justices described Congress's language as "obtuse" and "gibberish."

Other than agreeing that SLUSA's language was unclear, the Court appeared to offer divergent views on how to construe the language in question. Within the first several minutes of Cyan's argument, Justice Sotomayor questioned whether SLUSA's purpose was to divest state courts of jurisdiction over all '33 Act claims, as opposed to only removing its jurisdiction over claims asserting both '33 Act and state law claims. Justice Sotomayor also appeared to reject the contention that it was necessary to keep all '33 Act claims in federal court in order to apply a uniform set of standards for those cases. Justices Kagan and Ginsberg appeared to agree with Justice Sotomayor's position.

By contrast, Justice Gorsuch pressed Respondent to explain why, if the language was so carefully drawn, Respondent's position would treat one of the "except" clauses in § 77v(a) as superfluous.

Justice Alito began his questioning by referring to the statute as "gibberish." However, he then appeared to take issue with the interpretations being proposed by all sides.

Finally, Justice Breyer appeared intrigued by the Solicitor General's position that Congress did not deprive state courts of concurrent jurisdiction over suits asserting only '33 Act claims, but provided for the removal of those claims to federal court.

Justices Consider Whether the SEC's Definition of "Whistleblower" Should Govern the Reach of the Dodd-Frank Act's Anti-Retaliation Provisions

Section 922 of Dodd-Frank, codified as Section 21F of the Securities Exchange Act of 1934, created new rewards and employment protections

for individuals who report alleged violations of the securities laws. Section 21F(a) defines a whistleblower as “any individual who provides... information relating to a violation of the securities laws to *the Commission*, in a manner established, by rule or regulation, by the Commission.” 15 U.S.C. 78u-6(a)(6) (emphasis added). Section 21F’s anti-retaliation provision goes on to prohibit employers from firing or penalizing employees who, among other things, “mak[e] disclosures that are required or protected under the Sarbanes-Oxley Act of 2002.” In certain situations, Sarbanes-Oxley requires internal reporting before external reporting (e.g., auditors must inform management of any potentially illegal acts and may only bring their concerns to the SEC after this internal reporting has occurred). In 2011, the SEC promulgated a rule construing Section 21F, which interpreted the term “whistleblower” to include employees who make only internal disclosures of potentially wrongful activity.

The circuits are divided on whether an individual who reports alleged misconduct internally but does not report that misconduct to the SEC qualifies for the Dodd-Frank Act’s anti-retaliation protections. *Compare Asadi v. G.E. Energy (USA)*, 720 F.3d 620 (5th Cir. 2013) (holding that the Dodd-Frank Act’s definition of “whistleblower” “expressly and unambiguously requires that an individual provide information to the SEC”) with *Berman v. Neo@Ogilvy*, 801 F.3d 145 (2d Cir. 2015) (finding that the tension between the two relevant provisions of the Dodd-Frank Act “creates sufficient ambiguity” to require the court’s deference to the definition of ‘whistleblower’ in the SEC’s implementing regulations) and *Somers v. Digital Realty Trust*, 850 F.3d 1045 (9th Cir. 2017) (holding that the Dodd-Frank Act “necessarily bars retaliation against an employee of a public company who reports violations to the boss” but not to the SEC.)

Oral argument focused primarily on two issues. First, the Court considered whether to apply Dodd-Frank’s definition to both the Act’s rewards and anti-retaliation provisions, as opposed to just the Act’s rewards provisions. Second, the Court evaluated the extent to which it ought to defer to the SEC’s promulgated regulation if the statutory language is indeed determined to be ambiguous.

Which Definition of “Whistleblower” Applies?

Digital Realty contended that the statutory definition applied, “by its plain terms,” to the entirety of Dodd-Frank’s whistleblower provisions. This reading, counsel for the company claimed, is “entirely consistent” with Congress’s intent to increase the incentives for reporting violations of securities laws to the SEC. Moreover, the legislative history supports this view, as an earlier version of the anti-retaliation provisions “reached all employees,” but was revised to apply just to “whistleblowers.” Digital Realty noted that the Sarbanes-Oxley regime offers protections to employees who only make internal disclosures of potentially wrongful activity, and that Congress did not intend to render these protections superfluous with the enactment of Dodd-Frank. Citing the “elephant-in-a-mousehole” doctrine, Digital Realty argued that Congress would not have intended to create an “all-purpose anti-retaliation” regime through the use of ancillary provisions.

The United States, participating as amicus curiae to defend the SEC’s regulatory definition, disagreed with Digital Realty, asserting that the statutory definition applied to Dodd-Frank’s rewards provisions, while the ordinary meaning of “whistleblower” applied to the retaliation provisions. Further, there is a “unity of interest” among employees, employers, and the SEC in protecting and strengthening internal reporting and compliance.

Counsel for Somers emphasized that Dodd-Frank must be read as being consistent with the entire securities law framework, which is designed to respond to the conduct of employers rather than the mechanism through which an employee discloses potentially wrongful conduct. Finally, Somers’ counsel noted that Dodd-Frank was designed to strengthen, not contradict, the Sarbanes-Oxley regime, and that adopting Petitioner’s reading of the statute would frustrate this purpose.

The Justices evaluated the circumstances under which the Court should or could depart from Dodd-Frank’s definition of “whistleblower.” Justice Sotomayor noted she was “not sure there’s a natural reading [or ordinary meaning]” of the word “whistleblower.” Justice Gorsuch exclaimed that he was “just stuck on the plain language” of the text, wondering “how much clearer could Congress have been?” Chief Justice Roberts noted that, even if Congress inadvertently created an anomalous situation, the Court could not move beyond a clearly defined term unless a failure to do so would “make[] a mess of the whole thing.” Justice Breyer questioned if Dodd-Frank creates an anomaly at all, noting that internal whistleblowers still get Sarbanes-Oxley protections. Based on the questions posed, many of the Justices appeared wary of setting aside the Dodd-Frank definition based on the supposedly anomalous situations Somers and the government described.

How Much Deference Should the SEC’s Opinion Receive?

The Justices also questioned the parties about why the SEC’s promulgated rule defining “whistleblower” should be accorded *Chevron* deference. Justice Gorsuch, agreeing with Digital Realty, noted that when seeking public comment on its proposed rule, the SEC suggested it would be issuing a rule-making “with respect to whistleblowers who report to the Commission.” However, the agency’s final rule suggested, without any explanation, that reporting to the Commission would not be required for Dodd-Frank’s anti-retaliation provisions to apply.

Counsel for Somers contended that the SEC “specifically asked for comments about whether to broaden or change the definition of whistleblower for the purposes of the anti-retaliation [provisions].” Respondent further noted that, in a public comment in response to the proposed rule, the Association of Corporate Counsel noted their assumption that Dodd-Frank would also cover internal whistleblowers. The government added that under the “logical outgrowth test” adopted by the Supreme Court, an agency “proposing ‘X’ and getting ‘not-X’ is enough to satisfy” the requirements of the test.

However, some of the Justices seemed unconvinced by these arguments. Justice Breyer suggested that receiving notice that the SEC will be defining what counts as having provided information to the Commission “does not put people on notice that [the SEC is]...going to apply [the definition] to people who don’t provide information to the Commission,” adding “I mean, that’s English, I would think.” After the government’s logical outgrowth assertion, Justice Sotomayor asked, “Bottom line...how much are you relying on just *Chevron* deference here?” Given the skepticism the Justices expressed, it is unclear whether a majority of the Court believes that the SEC’s definition of “whistleblower” should be accorded deference in this case.

Authors and
Contacts

Paul Gluckow
Partner and General Counsel
pgluckow@stblaw.com
+1-212-455-2653

Jonathan Youngwood
Partner
jyoungwood@stblaw.com
1-212-455-3539

Peter Kazanoff
Partner
pkazanoff@stblaw.com
+1-212-455-3525

